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Supreme Court of the United States

October Term, 1941

No. 605

WALLACE GROVES, Petitioner

against

UNITED STATES OF AMERICA, Respondent

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

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Supreme Court of the United States

October Term, 1941

WALLACE GROVES,
Petitioner,

against

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above case on August 4, 1941, affirming the judgment of conviction of the United States District Court for the Southern District of New York, at the Borough of Manhattan, City and State of New York, convicting the petitioner of mail fraud and conspiracy in violation of Sections 37 and 215 of the Criminal Code.

Statement

The indictment named as defendants Wallace Groves (the petitioner), George S. Groves, Ernest B. Warriner, Philip DeRonde and four personal holding companies. Warriner and DeRonde were not apprehended and did not stand trial (fol. 127). The defendants on trial were convicted. Wallace Groves was fined $22,000 and sentenced

to two years (fols. 2531, 2532); George S. Groves was fined $22,000 and sentenced to eight months (fol. 2533); the corporate defendants were fined $1,000 each (fol. 2537).

On the appeal taken by the individual defendants, the Circuit Court, in an opinion by CLARK, *C. J.*, unanimously affirmed the conviction of the petitioner but reversed the conviction of George S. Groves.

The Fraud Charged

The indictment charged, in substance, that the defendants planned to gain control of and to defraud the General Investment Corporation,* an investment trust.

Essentially, the claim was that Wallace Groves, acting through the defendant Warriner, as his supposed alter-ego, secured control of GIC and then engaged in a transaction in its preferred stock at a profit to himself (fols. 61-77).

It was also charged that commissions paid to DeRonde and to Cica-Bracht, a firm of South American bankers, as compensation for the sale of certain securities of GIC, were not earned and were appropriated by defendants (fols. 77-80). Although it is contended that this was not proved as to the petitioner, the errors chiefly relied upon relate to the transaction in the GIC preferred stock.

Specifically, the evidence disclosed that in October, 1935, Warriner, formerly associated with Groves** in another transaction (fols. 1669-1671, 1675-1681), borrowed from him a substantial part of the funds (fols. 738, 739, 1717-1721; Gov. Exs. 6, 7, 130), which he utilized to purchase a minority stock interest in the International Equities Corporation (Gov. Ex. 27), a comparatively small investment trust (Gov. Ex. 73). Some months later, Warriner, acting this time without assistance from Groves,

* Hereinafter referred to as GIC.

** All references to "Groves" are to Wallace Groves.

acquired another block of International Equities stock, thereby obtaining control (fol. 544, Gov. Ex. 50).

In the early summer of 1936, it developed that a group of investors headed by David Milton and Ellery C. Huntington were willing to sell control of GIC, another investment trust, to International Equities, provided Warriner agreed to purchase a block of International Equities stock which they then held (fols. 1470, 1748; Gov. Ex. 67, Minutes 6/26/36; Gov. Ex. 159). Warriner agreed and this transaction was consummated in July, 1936.

The circumstances leading directly to the transaction complained of then occurred. Devendorf, a large stockholder in GIC and its former president (fol. 1176), having been deposed when Warriner assumed control, offered his minority stock to Warriner for the same price which Warriner had paid the Milton interests (fol. 1112). Warriner rejected this (fols. 1112, 1122), but told Devendorf that he would try to find another purchaser (fol. 1166). He then introduced Devendorf to Everett Bacon, of Spencer, Trask & Co., who, however, was not interested (fols. 1166, 1167).

Thereafter, Warriner introduced Devendorf to Groves (fols. 1119, 1120), who, after lengthy negotiations during December, 1936, agreed to purchase Devendorf's preferred stock at 87½ and his common stock at $1.50 (fol. 1125). Groves' offer to purchase the preferred was made available to all other preferred stockholders (fol. 1129; Gov. Ex. 121). Groves also purchased 3,000 shares of preferred at 100 from a group of Boston investors (fols. 1803, 1804).

After the Groves-Devendorf contract was executed but before delivery and payment, set for January 25, 1937 (fol. 1193), Groves re-sold 24,000 shares of preferred stock to GIC at 102 (fol. 1600; Gov. Ex. 71, Minutes 1/22/37, contract annexed). There is no dispute that the liquidating value of this stock was $150 per share (fols. 1186, 1188,

1189, 1212). Groves also sold to GIC 165,000 shares of common stock at $1.56, which was cost plus expenses (Gov. Ex. 61, fol. 2661; fol. 2107). The $300,000 profit which Groves made on the preferred stock is the gravamen of the prosecution.

The indictment charged that this preferred stock transaction was a fraud on GIC because Warriner misrepresented to the directors that he was not connected with Groves; that GIC could not have bought the stock at 87½; that he did not know that Groves was purchasing the stock until January, 1937; that he wanted GIC to buy the stock because Groves had a bad reputation in Wall Street, and he did not want anyone to think that Groves was connected with him (fols. 71-75).

It is undisputed that there was no direct evidence of any of these alleged misrepresentations. None of the directors claimed to have been deceived by Warriner was called to the stand. No relevant communication, written or oral, from Warriner to the directors was offered. All that appeared were formal directors' minutes which contained nothing but a summary statement of the terms of the proposal to buy from Groves (Gov. Ex. 71, fols. 2815, 2816).

Recognizing this absence of proof, the trial Judge submitted the case to the jury on the theory that if Warriner said nothing, the misrepresentations alleged were proved because Warriner thereby violated his duty as a fiduciary. The instruction was as follows (fols. 2471, 2472):

> "In this case, for instance, Warriner was president of General Investment Corporation. As president it was his duty under the law, as well as in morals and justice, to acquaint the directors of that company with all that he knew of the circumstances attending the Devendorf stock sale. His silence in that regard, indicated by the minutes of the corporation if you accept them, if intended by him to lull the directors into a belief that they were acting for the best inter-

ests of the corporation and doing something in ignorance which they would not have done with knowledge, would be a misrepresentation."

While it was urged to the Circuit Court that this was clear error, the Court made no mention of this instruction in its opinion but affirmed the conviction on another theory which constitutes the error chiefly relied on here. It held that whether or not representations were proved, Warriner and Groves had made a profit at GIC's expense. Since Warriner's interest was not disclosed to the directors, there was the use by a fiduciary of inside information to his own benefit and to the detriment of his *cestui*. Though not charged in the indictment, the Circuit Court held that this breach of fiduciary duty was within the contemplation of the mail fraud statute.

Although it was thus held that evidence of affirmative misrepresentation was not necessary to sustain the conviction, the Circuit Court also found that misrepresentations had been proved. This completely overlooked the fact that the trial Judge had instructed the jury that Warriner's non-disclosure was equivalent to misrepresentation. Under that instruction, proof of affirmative misrepresentation was not necessary to the verdict. The evidence of affirmative misrepresentation relied on by the Circuit Court was, therefore, not material to the issue submitted to the jury.

No Evidence of Misrepresentation

It is urged, however, that the insufficiency of evidence of affirmative misrepresentation upon which the Circuit Court relied is so clear as of itself to warrant review by this Court.

The Circuit Court found evidence of misrepresentation in the fact that the market price of the stock was 83 when GIC agreed to pay Groves 102. The argument is that the directors, unless somehow misled, would not have

paid 102 for stock selling at 83. It did not appear that the market price of 83 had any relation to the value of a block of 24,000 shares, involving an investment of approximately $2,000,000. Furthermore, even if this price were significant, it does not appear how it establishes specific misrepresentations.

In addition, evidence of misrepresentation to the corporation was found in the circumstance that Warriner made misrepresentations to Garver, attorney for GIC, several days prior to the meeting of the directors. Although Garver testified at the trial (fols. 1557-1647), there was no testimony by him that he communicated anything to the directors, though he was present at the meeting (fol. 1607). The Circuit Court said, nevertheless, that it was only reasonable to assume that Warriner's statements to Garver were made for the purpose of being relayed to the directors, and that they were. It is submitted that this reasoning from a purpose, itself inferred, to the actual doing of the act intended, is wholly unwarranted.

It will appear, moreover, that Warriner did not make all the alleged misrepresentations to Garver. Since all were submitted to the jury over objection, and since proof of any one would have been sufficient to support the verdict, all had to be established (*U. S.* v. *Smith*, 112 F. (2d) 83, 86; *U. S.* v. *Koch*, 113 F. (2d) 982, 984 [C. C. A. 2d]).

Finally, the Circuit Court suggested that Warriner's statement to the directors, contained in the minutes, that Groves would sell at 102 might be taken to imply all the essential misrepresentations alleged. This, the Court said, was because Groves received the stock under a trust imposed by law for GIC's benefit, and therefore was obligated to turn it over to GIC at 87½. It is not apparent how this proves the specific misrepresentations charged in the indictment.

Abuse of Grand Jury Process

Though the indictment in this case was handed up on December 1, 1938 (fol. 11), a Grand Jury subpoena was served upon Wallace Groves in a John Doe proceeding on February 6, 1941 (fol. 44), a week before the trial started. He appeared before the Grand Jury a day before the trial (fol. 1930), and, refusing to submit to what was obviously nothing more than an examination before trial, declined to answer questions relating to the merits of this case on the ground that the testimony would incriminate him (fols. 1970-1976). On the trial, the Government was permitted, over objection and exception, to show that Groves had exercised his privilege against self-incrimination before the Grand Jury (fols. 1969-1977).

Jurisdiction

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1935 (U. S. C. A. Title 28, Sec. 347).

The Questions Presented

1. Does the mail fraud statute extend to the mere use by a fiduciary of inside information to his own benefit and to the detriment of his *cestui que trust*?

2. Does the mail fraud statute apply to the purchase by a fiduciary for his own account of stock offered to the corporation, where the stock is subsequently resold by the fiduciary to the corporation at a profit to himself and the fiduciary does not disclose his interest in the transaction?

3. Is the mail fraud statute limited to facts which would give rise to a common law action for deceit? (On this the Second Circuit is in conflict with the Eighth Circuit, *Foshay* v. *U. S.*, 68 F. (2d) 205.)

4. If the mail fraud statute is not so limited and is interpreted to include "fraud in the sense of a court of equity", is the statute valid as forbidding the taking of any unjust or unconscionable advantage, under the rule of *U. S.* v. *Cohen Grocery Co.*, 255 U. S. 81?

5. Is evidence of non-disclosure by a fiduciary sufficient to support an indictment which charges fraud by affirmative misrepresentation? (On this, the instant decision is also in conflict with the Eighth Circuit, *Hass* v. *U. S.*, 93 F. (2d) 427.)

6. Is there any rational relationship between fact and inference in so much of the opinion of the Circuit Court which found that there was evidence of affirmative misrepresentation?

7. May the United States Attorney call a defendant before the Grand Jury the day before the trial and compel him either to testify, and thereby give the Government in effect an examination before trial of his defense, or claim his privilege which will later be used against him on cross examination?

Reasons for Granting the Writ

1. The questions presented are of public importance. The Circuit Court's decision must necessarily result in the broad expansion of federal criminal jurisdiction to encompass the vast area of fiduciary disloyalty. The federal criminal courts must now regulate the conduct, not only of corporate officers and directors, but of trustees of express trusts, guardians, executors, agents, partners, joint adventurers, members of protective committees and of the innumerable persons held, under particular circumstances, "to distinctive standards of fidelity and honor."*

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* *Buffum* v. *Barccloux*, 289 U. S. 227, 237, Mr. Justice Cardozo.

The rule of this case requires that there be included within the mail fraud statute any undisclosed advantage taken by a trustee in the administration of a trust. Numerous instances may be conceived in which fiduciaries enter into transactions affecting their respective *cestuis*, which, though not condonable in equity, have never been thought criminal. The trustee acting through a nominee buys real property useful to the estate and resells it to the estate for a fair price but at a profit to himself. The protective committee member trades in the deposited securities or participates as an undisclosed purchaser in the reorganization sale. The corporate officer, far-sightedly anticipating expansion, purchases the new enterprise himself and on the subsequent sale to his company takes the profit which otherwise would accrue to another. These instances may be multiplied indefinitely. In each, there is the use by a fiduciary of inside information to his benefit and to the detriment of his *cestui*.

A statute in terms rendering criminal the use of inside information by a fiduciary would, under established principles, be held repugnant to the Constitution by reason of vagueness and uncertainty (*Lanzetta* v. *New Jersey*, 306 U. S. 451). Certainly, it cannot be said that the mail fraud statute was intended by Congress to cope with breaches of trust.

The effect of the decision, moreover, is not only immensely to broaden federal criminal jurisdiction, but to introduce into the criminal law a wholly different standard of conduct. It is traditional that "equity is so much more ethical than law" (*Ames, Origin of Uses*, Vol. 2, Select Essays in Anglo-American Legal History, page 738). And, in the striking phrases of Mr. Justice CARDOZO in *Buffum* v. *Barceloux, supra* (p. 237):

> "Equity has its distinctive standards of fidelity and honor, higher at times than the standards of the market place. *Meinhard* v. *Salmon*, 249 N. Y. 458, 468; 164 N. E. 545. Whoever is a fiduciary or in

conscience chargeable as a fiduciary is expected to live up to them."

More recently, this Court said, in *Woods* v. *City Bank Co.*, 312 U. S. 262, by Mr. Justice DOUGLAS, at page 269:

> "Only strict adherence to these equitable principles can keep the standard of conduct for fiduciaries 'at a level higher than that trodden by the crowd.' "

This standard must inevitably be relied upon in the interpretation of facts claimed to show a selfish use of "inside information". There are circumstances under which a corporate officer may properly take for himself an opportunity for profit which he might have turned over to the corporation. Whether a breach of duty has occurred must be determined "in accordance with the highest standards which a man of the most delicate conscience and the nicest sense of honor might impose upon himself" (*Cardozo, Nature of the Judicial Process*, pp. 109, 110).

It may further be pointed out that the rule stated in this case conflicts with the principle enunciated in *Shushan* v. *U. S.*, 117 F. (2d) 110, 115 (C. C. A. 5th), to the effect that the mail fraud statute is not applicable to constructive frauds. The question presented, therefore, also involves a conflict of view between the Second and Fifth Circuits.

2. There is a conflict of view between the Circuit Court of Appeals for the Second Circuit and the Circuit Court of Appeals for the Eighth Circuit on the proposition that the mail fraud statute is limited to facts which would give rise to a common law action of deceit.

In this case, the Circuit Court of Appeals for the Second Circuit has held that the crime is not deceit. It said:

> "First, the statute is not limited to what would give rise to a civil action, in spite of what was said in another connection in *United States* v. *Brown*, 2 Cir., 79 F. 2d 321, certiorari denied 296 U. S. 650, 56 S. Ct. 309, 80 L. Ed. 462; . . . "

A different view was expressed in *U. S.* v. *Brown*, 79 F. (2d) 321 (C. C. A. 2d), where LEARNED HAND, *C. J.*, said:

> "The crime was deceit, and we agree with the Eighth Circuit that the liability runs *pari passu* with civil liability. *Foshay* v. *U. S.*, 68 F. (2d) 205, 211 (C. C. A. 8th)."

This doctrine of the *Brown* case having been in effect overruled in the pending case, there is a square conflict of view between the Second and Eighth Circuits on this issue.

In *U. S.* v. *Brown, supra*, it was furthermore stated by Judge LEARNED HAND that the view that mail fraud was tantamount to deceit followed from the decisions of the Supreme Court in *Durland* v. *U. S.*, 161 U. S. 306, and *U. S.* v. *Comyns*, 248 U. S. 349. And, in *Fasulo* v. *U. S.*, 272 U. S. 620, it was held that the mail fraud statute was not applicable to extortion though the conduct was stated to be more reprehensible than deceit.

It is submitted, moreover, that the decision of this case conflicts with the rule of *Neal* v. *Clark*, 95 U. S. 704, that the term fraud in the bankruptcy statute is limited to "positive" fraud.

There is, therefore, not only a conflict between the Second and Eighth Circuits on this question, but the decision in this case is in conflict with the decisions of the Supreme Court in *Durland* v. *U. S.*, *U. S.* v. *Comyns*, and *Fasulo* v. *U. S.*, all *supra;* and is not consonant with the rule of *Neal* v. *Clark*, 95 U. S. 704.

3. There is conflict between the decision of this Court and the decision of the Eighth Circuit in *Hass* v. *U. S.*, 93 F. (2d) 427 (C. C. A. 8th).

Here, the Court has held that Warriner's silence in violation of a duty to speak established the offense charged of mail fraud by false representation. In *Hass* v. *U. S.*, *supra*, where the indictment similarly charged mail fraud

by misrepresentation, the Eighth Circuit held that similar proof of non-disclosure by a fiduciary was insufficient to prove the crime charged and the conviction was reversed.

There is, therefore, a conflict of view between the Second Circuit and the Eighth Circuit upon the sufficiency of proof of non-disclosure by a fiduciary to support an indictment which charges fraud by false representation.

4. The defendant's privilege against self-incrimination was violated when the Government was permitted to cross examine the defendant on the claim of his privilege before the Grand Jury where he was summoned to appear the day before the trial began. The rule enunciated in this case is not supported by the doctrine of *Raffel* v. *United States,* 271 U. S. 494, where this Court held that a defendant having refused to testify at one trial could be cross examined to elicit that fact on a subsequent trial. The *Raffel* case does not authorize a practice by which in every case the United States Attorney will be enabled to use the process of the Grand Jury to compel the defendant either to disclose his defense in advance of trial or appear before the jury as having, in effect, admitted that his version of the facts would incriminate him.

5. The Circuit Court erred in holding that there was evidence of the misrepresentations charged in the indictment. The insufficiency of the proof is so clear as to warrant review by the Supreme Court. (*Robertson and Kirkham,* Jurisdiction of the Supreme Court of the United States, § 304; *Reynolds* v. *United States,* 292 U. S. 443; *Southern Railway Co.* v. *Walters,* 284 U. S. 190.)

WHEREFORE your petitioner respectfully prays that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals herein be granted.

JAMES B. ALLEY,
Attorney for Petitioner.

Dated, New York, N. Y., September 10, 1941.